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William F. Maher, Chief, Wireline Competition Bureau
Federal Communications Commission
The Portals, 445 12th Street, SW
Room TW-A325
Washington, DC 20554

EX PARTE

Re: CC Docket No. 01-338
Critique of WorldCom "MiCRA Model"

Dear Mr. Maher:

BellSouth is filing this letter in response to WorldCom's filing of January 23, 2003, wherein WorldCom purported to address "SBC's and BellSouth's critiques of MiCRA's model and WorldCom's cost-based impairment analysis."[1]

Costs versus Revenue

WorldCom contends that recent filings by WorldCom, SBC and AT&T "all show that competing carriers using UNE-L to serve residential customers have higher costs than incumbent LECs." WorldCom provides no support for this contention. Indeed, none of the filings referenced by WorldCom even attempt to set forth the actual costs that an ILEC incurs to serve residential customers. According to WorldCom's *ex parte*, "MiCRA used UNE-P rates as a surrogate for the ILEC's costs to serving their retail customers." Of course, UNE-P rates cannot be used as a representation of the ILECs' actual cost of providing service. At best, UNE-P rates represent the costs associated with a forward-looking, most efficient, hypothetical network. At worst, UNE-P rates do not even cover the costs of this hypothetical network, much less an actual network, due to the downward adjustments made by the state commissions.

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1 Letter from Ruth Milkman, Counsel for Worldcom, to Marlene H. Dortch, Secretary, Federal Communications Commission (Jan. 23, 2003).

BellSouth's recent *ex parte* demonstrates that, based on WorldCom's own analysis, CLECs can profitably serve both residential and business customers in wire centers with greater than 5,000 total lines.[2] Of course, as BellSouth discussed in its presentations, the appropriate comparison is cost to potential revenue, not cost to UNE-P rate. That is, the margin between the cost of providing local service and the revenue available to the CLEC determines whether a CLEC can economically enter a market to provide local service.

In its January 23, 2002 written *ex parte* submission WorldCom includes a slide entitled "Costs, not Margins, Are Relevant to Impairment Analysis," that juxtaposes *dicta* from *USTA v. FCC*[3] to suggest that an analysis of margins is inappropriate both as a matter of fact and as a matter of law.[4] If this is what WorldCom intended to convey, it is simply incorrect on both counts. In the first case, Professor Shelanski has already demonstrated why it is relevant in an impairment analysis to consider whether, under current retail rates, UNE-L would provide positive margins for CLECs.[5] WorldCom, in its "Costs, not Margins" slide, continues to argue that incumbents are in a position to "lower retail prices because it has lower costs" and that they "face the real risk of price cuts by incumbents whose costs are much lower than theirs."[6] However, these unsupported statements do not answer the critique of Professor Shelanski:

> WorldCom devotes much of its analysis to arguing that UNE-L would impose higher costs than UNE-P on CLECs. Only by the circular logic of equating UNE-P with ILEC costs, and moreover by ignoring actual empirical evidence of entry by means other than UNE-P, does that comparison possibly say anything about competitive impairment. WorldCom never undertakes another calculation that would be useful to making competitive predictions: whether, under current retail rates, UNE-L would provide positive margins for CLECs. WorldCom's implicit answer is that current retail rates do not matter because the ILEC will use its alleged cost advantage to lower retail prices. But even if one assumes a material cost disparity to exist, one cannot simply assume the real-world feasibility of downward pricing by the ILECs, especially in the residential context to which WorldCom restricts its analysis. Indeed, such assumptions of downward pricing responses are particularly unwarranted where they are based on a TELRIC proxy that likely understates ILEC costs and therefore overstates the margins available to be decreased.[7]

Nor can the *dicta* excerpted out of context from the *USTA* case in any way be construed to support WorldCom's assertions as a matter of law. The statement was merely a generalization that the Court of Appeals used to begin its discussion of the "kinds of cost disparities" that are appropriate for a section 251 impairment analysis in light of the U. S. Supreme Court's vacating

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2 Letter from Robert T. Blau to Marlene H. Dortch (Jan. 17, 2003).

3 290 F.3d 415 (D.C. Cir. 2002) ("*USTA*").

4 WorldCom *ex parte, supra* n.1 at 3.

5 *See* Letter from Howard A. Shelanski, submitted with SBC memorandum of *ex parte* communication (Jan. 14, 2003) ("Shelanski Rebuttal").

6 *Supra,* n.4.

7 Shelanski Rebuttal at 4.

the Commission's first set unbundling for use of an overbroad impairment standard based on cost assumptions that were inconsistent with the statute,[8] and the Commission's subsequent promulgation of a new set of rules that were again alleged to be unsupported by a cost analysis consistent with the statute. The Court of Appeals went on to observe that the Commission's second set of unbundling rules relied on cost assumptions that "are universal as between new entrants and incumbents" and that ignored the "costs" associated with unbundling – including "the disincentive to invest in innovation and creating complex issues of managing shared facilities."[9] Rhetorically, after conducting its analysis, the court concluded where it started – while, "[of] course, any cognizable 'impairment' would necessarily be traceable to some kind of disparity in cost,"[10] the "Commission's concept of 'impairing' cost disparities [in the *UNE Remand Order*] is so broad and unrooted in any analysis of the competing values at stake in implementation of the Act" [11] that the Court was unable to uphold any of the UNE mandates.

WorldCom's use of this language from *USTA* cannot properly be construed to demonstrate that that case stands for the proposition, as a matter of law, margins are irrelevant in an impairment analysis. Indeed, in the context of its discussion about costs in its decision vacating the Commission's first set of unbundling mandates, the United States Supreme Court specifically addressed profits:

> An entrant whose anticipated annual profits from the proposed service are reduced from 100%of investment to 99% of investment has perhaps been "impaired" in its ability to amass earnings, but it has not *ipso facto* been "impaired . . . in its ability to provide the services it seeks to offer"; and it cannot realistically be said that the network enabling it to raise its profits to 100% is "necessary."[12]

Margins are highly relevant in a statutorily grounded impairment analysis, indeed, as Professor Shelanski explains, it is only by using "the circular logic of equating UNE-P with ILEC costs, and moreover by ignoring actual empirical evidence of entry by means of entry other than UNE-P," assumptions that have been clearly rejected by the United States Supreme Court,[13] that WorldCom "possibly" says "anything about competitive impairment."[14] But even based on a shaky and illegal foundation, this only gets WorldCom to a starting point – cost disparities may exist as between ILECs and CLECs. WorldCom never shows why these are not the "kinds of cost disparities" that are "faced by virtually any new entrant in any sector of the economy, no

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8 *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366, 389-92 (1999).

9 *USTA,* 290 F.3d at 427.

10 *Id.* at 426.

11 *Id.* at 428.

12 *Iowa Utils. Bd.,* 525 U.S. at 390 (Scalia, J., expressly disagreeing with Justice Souter's contention that "a business can be impaired in its *ability* to provide services – even impaired in that ability "in an ordinary, weak sense of impairment," . . . when the business receives a handsome profit but is denied an even handsomer one")(emphasis in original).

13 *Id.* at 389-92 (vacating unbundling rules for failure to consider availability of elements outside the incumbent's network).

14 Shelanski Rebuttal at 4.

matter how competitive the sector."[15] The fact that the Court of Appeals acknowledged that "any cognizable competitive 'impairment'" is necessarily "traceable to some kind of disparity in cost" does not meant that whenever WorldCom alleges the existence of cost disparities it has thus, in the words of the Supreme Court, "*ipso facto* been 'impaired . . . in its ability to provide the services it seeks to offer.'"[16]

WorldCom's Estimation of Costs

With regard to OSS,[17] Transport and Digitization costs, although BellSouth does not necessarily endorse WorldCom's estimated costs, in order to simplify the analysis, BellSouth assumed those costs in its analysis. WorldCom points out that SBC's analysis assumed virtual collocation, which is less expensive than physical collocation. BellSouth's analysis assumed physical collocation; however, it assumed actual rates that would be charged to any CLEC requesting physical caged collocation in Georgia.[18] BellSouth's January 15 -17 *ex parte* presentations included information showing how the collocation costs were calculated. Assuming that WorldCom requested every possible element associated with obtaining physical collocation, the nonrecurring charges would be approximately $17,000 (substantially less than the $120,000 price assumed by WorldCom) and the monthly recurring charges would be approximately $1,700 (compared to WorldCom's estimate of $2,500 per month).

BellSouth's analysis used WorldCom's cost estimations for each element except collocation. BellSouth also included an estimate of overhead expenses and an average cost for the UNE-L. It is clear from BellSouth's analysis that, when costs are appropriately compared to revenue, CLECs can economically serve customers in wire centers with more than 5,000 total lines.

Unbundled Loop Provisioning and Hot Cuts

BellSouth's processes and performance related to UNE-L provisioning and hot cuts are reliable. Indeed, data that BellSouth provided in its December 23, 2002, *ex parte* presentation shows excellent performance.[19] In addition, the state commissions in BellSouth's serving area have established a broad set of loop provisioning measures and standards, including meaningful penalties. Due to the availability of the UNE-P, BellSouth is not currently provisioning tens of thousands of UNE-Ls each month. Prior to the ramp-up of UNE-Ps, however, BellSouth provisioned approximately 734,000 UNE-Ls. BellSouth has reviewed its processes and its current workforce and has determined that it can successfully meet significantly increased

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15 *USTA,* 290 F.3d at 426.

16 *Iowa Utilities Board*, 525 U.S. at 390.

17 WorldCom laments yet again that it has not built OSS for UNE-L. Of course, unlike many other CLECs, WorldCom chose not to compete in the local residential market until UNE-P was available. Obviously, other CLECs built OSS for UNE-L, and certainly WorldCom can do so in order to purchase unbundled loops.

18 Collocation rates in Georgia are among the highest in BellSouth's region.

19 Letter from Robert T. Blau to Marlene H. Dortch, (Dec. 24, 2002).

demand for UNE-Ls. All of the factual evidence in the record of this proceeding demonstrates that ILECs have met every challenge to date in providing exceedingly high-performance on hot cuts and that they have the capability to do so on an increased scale, as necessary. On the other side of the coin, there is simply nothing in the voluminous record of this proceeding – other than conjecture – to support the allegations that ILECs could not meet anticipated demand.

Collocation Intervals

In its January 8, 2003, *ex parte*, WorldCom stated that "obtaining the collocation space, constructing the cage and making sure the collocation is ready to accept new lines will take about 14 months." In its January 23, 2003, *ex parte*, on page 7 under the heading Collocation Interval, WorldCom cryptically stated that the "[t]imeframe for SBC would be four months assuming leased transport." It is not clear whether WorldCom is now contending that collocation intervals are 4 months rather than 14 months. Nonetheless, BellSouth consistently meets intervals of 3 months for new sites and 2 months for augments to existing sites.

Conclusion

In its January 23, 2003, *ex parte*, WorldCom does not provide any meaningful response to BellSouth's correction of WorldCom's flawed analysis presented in WorldCom's January 8, 2003, *ex parte*. WorldCom contends that margins are not relevant to the impairment analysis; however, as explained above, WorldCom is incorrect. Rather, it is any comparison of CLEC costs with rates set by state commissions based upon – or more typically, below – a hypothetical TELRIC network that simply has no economic basis. Once that point is understood, WorldCom's analysis simply affirms BellSouth's position that CLECs are not "impaired," within the meaning of the statute, without access to local switching on an unbundled basis in wire centers with greater than 5,000 total lines.

Sincerely,

Glenn T. Reynolds

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